

# Joint Economic Committee WEEKLY ECONOMIC DIGEST

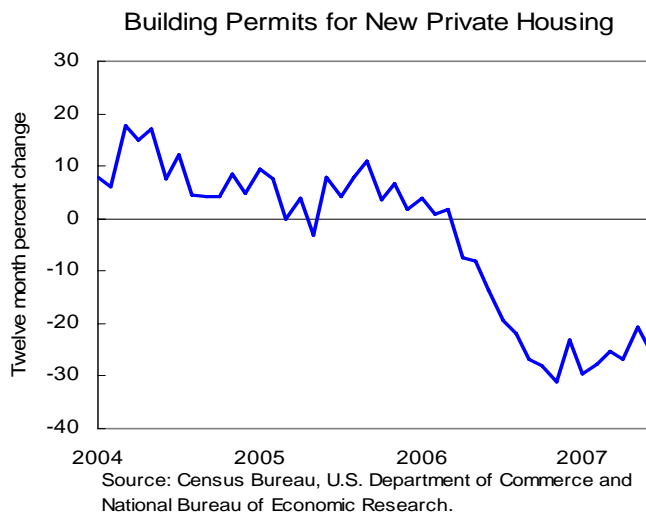
Senator Charles Schumer, Chairman  
Congresswoman Carolyn Maloney, Vice Chair

July 23, 2007

## ECONOMIC NEWS

### Despite June Improvements, New Homebuilding and Manufacturing Remain Concerns

**New homebuilding rose last month, but underlying data suggest continued weakness.** New construction of privately owned housing increased by 2.3 percent in June to 1.467 million units at an annual rate last month. But that rise was concentrated in multi-family housing—new construction of single-family homes fell by 0.2 percent in June. Moreover, permits to build new homes plunged by 7.5 percent in June, the largest monthly decline since January 1995. Permits are now 25.2 percent below their level a year ago reflecting continued pessimism among builders (see chart).



**Industrial production rebounded in June, but factory output remains weak.** Industrial production in manufacturing, mining, and utilities increased by 0.5 percent last month, following a 0.1 percent decline in May. Manufacturing output grew by 0.6 percent in June, after growing merely 0.1 percent, on average, over the previous two months. Even so, manufacturing output is only 1.6 percent above last year's level, well below the 12-month pace of recent years.

**Energy prices dropped slightly in June, tempering overall inflation.** The consumer price index (CPI) increased by 0.2 percent last month, following a 0.7 percent rise in May. Prices paid by consumers for energy declined by 0.5 percent in June, after climbing at an average monthly rate of 3.6 percent between February and May. The core CPI (which excludes the volatile prices of food and energy) rose by 0.2 percent in June, up slightly from May's 0.1 percent increase. Over the past 12 months, the overall CPI has risen by 2.7 percent, and the core CPI by 2.2 percent.

## IN FOCUS

### Fed Clarification—Some Offered, More Needed

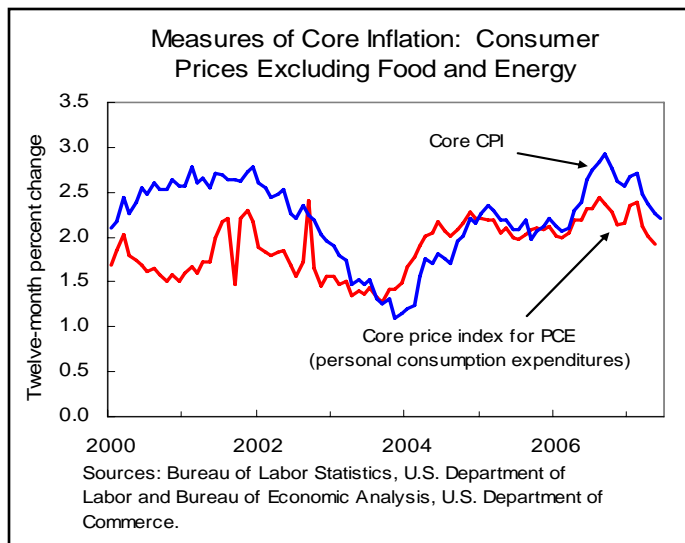
In a wave of communications last week, the Federal Reserve clarified its view of the near-term economic outlook and monetary policy. On Wednesday and Thursday, Chairman Ben Bernanke testified before the House and Senate on the Fed's updated Monetary Report to Congress, noting the surprising persistence of the housing slump and the risks associated with ongoing deterioration in subprime mortgage markets. On Friday, those risks were underscored in a speech by William Poole, President of the St. Louis Federal Reserve, who remarked that the non-prime mortgage market "clearly is large enough to affect aggregate homebuilding activity and consumer spending." Also on Friday, the Fed released the minutes of the June 28 meeting of the Federal Open Market Committee (FOMC), the committee that decides the direction for monetary policy. At that meeting, members raised more concerns than they have before about housing and the risks of spillover.

Even so, the rising tide of Fed concerns over housing did not spill over into any reassessment of the stance the FOMC has maintained since March that inflation is the predominant risk facing monetary policy over the near term.

The Fed now believes the economy is likely to grow just 2.4 percent over the course of this year (the midpoint of the range of forecasts that the Fed calls "central tendency"). That is down 0.4 percentage point from the 2.8 percent

*Continued on reverse...*

## SNAPSHOT



# Joint Economic Committee WEEKLY ECONOMIC DIGEST

## THE WEEK AHEAD

DAY	RELEASE
Wednesday 25	Existing Home Sales (June 2007) JEC Hearing: "A Local Look at the National Foreclosure Crisis: Cleveland Families, Neighborhoods, Economy Under Siege from the Subprime Mortgage Fallout," 216 Hart Senate Office Building, 10 AM
Thursday 26	Full Report on Manufacturers' Shipments, Inventories and Orders (June 2007) New Residential Sales (June 2007)
Friday 27	Gross Domestic Product (advance estimate, second quarter 2007) Annual Revisions of the National Income and Product Accounts (first quarter 2004 through first quarter 2007)

*Friday,  
July 27th:  
First look at  
second-quarter  
economic  
growth*

## THE ECONOMY AT A GLANCE

KEY INDICATORS	MONTH			QUARTER			YEAR	
	June	May	Apr	2007 Q2	2007 Q1	2006 Q4	2006	2005
Real GDP Growth (%)	—	—	—	n.a.	0.7	2.5	3.3	3.2
Unemployment (% of labor force)	4.5	4.5	4.5	4.5	4.5	4.5	4.6	5.1
Labor Productivity Growth (%)	—	—	—	n.a.	1.0	2.1	1.6	2.1
Labor Compensation Growth (%)	—	—	—	n.a.	3.2	3.6	3.1	3.3
CPI-U Inflation (%)	2.4	8.7	4.9	6.0	3.8	-2.1	3.2	3.4
Core CPI-U Inflation (%)	2.4	1.2	2.4	1.9	2.3	1.9	2.5	2.2

Sources: Bureau of Economic Analysis, U.S. Department of Commerce; Bureau of Labor Statistics, Department of Labor.

Notes: Except where otherwise noted, values in the table represent percent changes at seasonally adjusted annual rates. Productivity is output per hour worked in private nonfarm businesses. The Employment Cost Index is for civilian workers in government and business. Core CPI-U inflation is the percent change in the CPI-U excluding food and energy as reported by the Bureau of Labor Statistics. The designation "n.a." denotes that data are not yet available.

## IN FOCUS (Continued)

growth the Fed deemed likely in February. The downgrading of the 2007 forecast reflects the effects of the economy's anemic growth in the first quarter (0.7 percent at an annual rate) and a predicted rebound in the neighborhood of 3 percent in the second quarter (advance data for the second quarter will be released by the Department of Commerce on Friday).

However, to a surprising degree, the Fed also downgraded its growth outlook for next year as well. The Fed now expects that the economy is likely to grow at a 2.6 percent rate over the course of 2008. That is 0.3 percentage point below the 2.9 percent pace the Fed had deemed likely in February and, more clearly, below the pace of growth that economists regard as sustainable over the near term. The apparent reason for the downward revision to the 2008 growth forecast is housing: "declines in residential construction will continue to weigh on economic growth over coming quarters, although the magnitude of the drag on growth should diminish over time," Chairman Bernanke testified.

If the Fed's outlook for near-term growth is more modest, its outlook for inflation is unchanged from February. The Fed continues to expect core inflation to moderate this year and next: measured by the change in the price index for personal consumption expenditures (PCE) excluding food and energy, core inflation is likely to average 2.1 percent over the course of this year, and 1.9 percent next year. That unchanged projection suggests that the Fed is not yet convinced that recent moderation in a variety of measures of core inflation (see Snapshot) has been sufficient to diminish inflation as the predominant near-term risk to monetary policy.

Financial markets expect the FOMC to maintain its target rate for federal funds at 5¼ percent when it meets on August 7. But will the FOMC retain its anti-inflation tilt, which continues to imply that rate hikes are likelier than rate cuts over the near term?